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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 695

DETROIT & WINDSOR FERRY COMPANY, A MICHIGAN
CORPORATION, PETITIONER

v.

FRED L. WOODWORTH, INDIVIDUALLY AND AS FORMER
COLLECTOR OF INTERNAL REVENUE OF THE UNITED
STATES OF AMERICA FOR THE FIRST DISTRICT OF
MICHIGAN

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court is unreported.
(R. 166-169.) The opinion of the Circuit Court
of Appeals for the Sixth Circuit (R. 180-185) is
reported in 115 F. (2d) 795.

JURISDICTION

The judgment of the Circuit Court of Appeals
was entered November 13, 1940. (R. 179.) The
petition for a writ of certiorari was filed January

13, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 936.

QUESTION PRESENTED

Petitioner operates a ferry business which has suffered diminution as a result of the construction of a competing bridge and vehicular tunnel. Is it entitled to a deduction on account of "obsolescence" under Sec. 23 (k) of the Revenue Act of 1928, notwithstanding that it continues to conduct its business without abandonment of its facilities?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(k) *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 206. *Obsolescence*.—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future

date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

STATEMENT

The District Court's findings of fact (R. 160-163) may be summarized as follows:

The taxpayer, a Michigan corporation, has been engaged for many years in the business of operating ferry boats between Detroit, Michigan, and Windsor, Canada, and operating excursion boats between Detroit and nearby resorts. In 1929 and 1930, the taxable years in question, the taxpayer owned and operated in its business the ferry boats *Brittania*, *LaSalle*, and *Cadillac*, and continued to operate them until the time of this action. The

Cadillac was obtained and put into operation by the taxpayer in April, 1928. A fourth boat, the *Pleasure*, owned and used by the taxpayer during a part of 1929, was retired in the latter part of that year. (R. 160.)

In Detroit the taxpayer has continuously operated under a city ordinance, paying a yearly license fee. In Windsor the taxpayer operated under a charter from the Dominion of Canada until February, 1937, the charter having been renewed several times upon the taxpayer's application between the time of the opening of the bridge and tunnel hereinafter mentioned and February, 1937. Since February, 1937, the taxpayer's ferry boats have cleared as foreign ships on the Windsor side on each trip. (R. 161.)

In May, 1927, the taxpayer was informed that an international bridge was to be constructed over the Detroit River between Detroit and Windsor, about two miles from the ferry, to be opened in August, 1930. Construction of the bridge was begun in May, 1927, and the bridge was opened to travel November 15, 1929, nine months ahead of schedule. In September, 1927, taxpayer was informed that a pedestrian and vehicular tunnel under the Detroit River was to be constructed, to be opened in 1930. Construction was begun in June, 1928, and the tunnel was opened to travel November 3, 1930. In each of the years 1931 to 1937, inclusive, the taxpayer operated its ferry business at a loss, using therein as its principal income producing property

all of the assets upon which it claims obsolescence deductions for 1929 and 1930. In each of those years it carried several hundred thousand cars, the number varying from 744,000 in 1931 to 320,000 in 1936. In each of those years it carried a large number of foot passengers, the number varying from 4,021,000 in 1931 to 1,795,000 in 1936. (R. 161.)

The taxpayer has at no time concluded or determined that any of the assets upon which obsolescence deductions are claimed for the years 1929 and 1930 would be abandoned or discontinued as non-useable income producing property in its ferry business at any time prior to the end of their normal useful life. Late in 1927 or early in 1928, the taxpayer did conclude that its ferry business could not be conducted at a profit after December, 1930, when it understood that the bridge and tunnel would be opened to traffic, but at no time has the taxpayer ever determined to discontinue the operation of its ferry business, and at the time of trial it had no intention of discontinuing the operation of the business at any definite time. (R. 162.)

The ferry boats and equipment upon which obsolescence deductions are claimed have been continuously used up to the time of this suit for the purposes for which they were acquired and at the time of the trial they were being used for such purposes. They were at such time and have continuously been the principal income producing factors in the taxpayer's ferry business. (R. 162.)

In its income tax return for 1928, the taxpayer deducted \$365,059.61 as "obsolescence" on the boats and equipment in question. The Commissioner reduced this deduction to \$227,384.67 and determined an income tax deficiency accordingly, which was assessed November 22, 1930, and paid by the taxpayer in due course. The question raised in the instant case, that is, the propriety of such an obsolescence deduction, was not raised by the Commissioner for the year 1928. (R. 162.)

In May, 1930, taxpayer filed its income tax return for 1929, reporting a liability of \$43,641.58, and showing a deduction of \$358,755.16 as "obsolescence" on its ferry boats and equipment. The Commissioner disallowed the entire deduction and assessed a deficiency of \$37,174.95, which the taxpayer paid, together with \$6,652.28 interest. In redetermining the taxpayer's taxable income for 1929, the Commissioner did allow a deduction of \$49,437.03 on account of the loss of useful value of the *Pleasure* which was retired in 1929. (R. 162-163.)

In March, 1931, the taxpayer filed its income tax return for 1930, reporting no tax due and showing a deduction for "obsolescence" on boats and equipment in the amount of \$358,755.18. The Commissioner disallowed the deduction and found a deficiency in tax of \$31,451.26, which the taxpayer paid, together with \$4,076.17 interest. (R. 163.)

In computing the taxable income for the years 1929 and 1930, the Commissioner allowed normal depreciation deductions with respect to the assets

in question. The taxpayer filed timely claims for refund for the years 1929 and 1930 and upon their disallowance by the Commissioner brought this suit for refund. (R. 163.) The District Court held that the assets in question were not in the process of becoming obsolete since it did not appear that they would become unuseable to the taxpayer in business prior to the termination of their normal useful lives. (R. 164-169.) Judgment was entered for the Collector. (R. 170.) The Circuit Court of Appeals affirmed. (R. 179-185.)

ARGUMENT

The taxpayer urges (Br. 12, *et seq.*) a conflict with *Burnet v. Niagara Brewing Co.*, 282 U. S. 648; *Gambrinus Brewery Co. v. Anderson*, 282 U. S. 638; and *U. S. Cartridge Co. v. United States*, 284 U. S. 511.

None of those cases dealt with a regulation like Article 206 of Treasury Regulations 74, *supra*, which is controlling here. All of those cases involved the Revenue Act of 1918, c. 18, 40 Stat. 1057. A regulation like that here applicable first appeared as Article 166 of Treasury Regulations 65, promulgated under Section 214 (a) (8) of the Revenue Act of 1924, c. 234, 43 Stat. 253. Subsequently both the statute and regulation have been repeated without change here material, as follows: Article 166, Treasury Regulations 69, with reference to Section 214 (a) (8) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Article 206, Treasury Regulations 74, with

reference to Section 23 (k) of the Revenue Act of 1928; Article 206 of Treasury Regulations 77, with reference to Section 23 (k) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Article 23 (1)-6 of Treasury Regulations 86, 94 and 101, with reference to Section 23 (1) of the Revenue Acts of 1934, c. 277, 48 Stat. 680; 1936, c. 690, 49 Stat. 1648; and 1938, c. 289, 52 Stat. 447, respectively. If these regulations do not arbitrarily depart from the statute they are within the competence of the Commissioner and should be controlling. Cf. *Helvering v. Wilshire Oil Co.*, 308 U. S. 90; *Helvering v. Winmill*, 305 U. S. 79, 83; *Morgan v. Commissioner*, 309 U. S. 78, 81. That these regulations do not go beyond the statute is confirmed by *Real Estate Title Co. v. United States*, 309 U. S. 13, where they were cited and quoted with apparent approval (pp. 15-16).

The regulations require the taxpayer to show "clearly" conditions which will result in the property's "being abandoned at a future date prior to the end of its normal useful life." In the instant case the taxpayer's ferry business was subjected to greatly increased competition when a bridge and tunnel were opened in 1929 and 1930, but it has not abandoned its business and has denied any intention of doing so. The assets claimed to be obsolete and sought to be charged off in the three years 1928, 1929 and 1930, continued to be the principal income producing factors in the taxpayer's ferry

business, up to the time of the trial in 1938. The Circuit Court of Appeals correctly determined that there was no showing that the assets would have to be abandoned prior to the termination of their normal useful life.

Moreover, apart from the fact that the cases relied upon by petitioner did not involve the regulations here applicable, they are further distinguishable because each involved property which could not continue to be applied to the use for which intended.

The Circuit Court of Appeals for the Third Circuit, upon facts in many respects similar to those in the instant case, refused to allow deductions for obsolescence in *State Line & Sullivan R. Co. v. Phillips*, 98 F. (2d) 651 (C. C. A. 3d), and this Court denied certiorari, 305 U. S. 635.

CONCLUSION

The decision of the Circuit Court of Appeals is not in conflict with any decision of this Court or any other Circuit Court of Appeals. It is respectfully submitted that the petition should be denied.

FRANCIS BIDDLE,

Solicitor General.

SAMUEL O. CLARK, Jr.,

Assistant Attorney General.

SEWALL KEY,

ARTHUR A. ARMSTRONG,

Special Assistants to the Attorney General.

JANUARY, 1941.